



**International
Finance Corporation**
World Bank Group

Carbon Finance: Perspectives of a Financier

**International Finance
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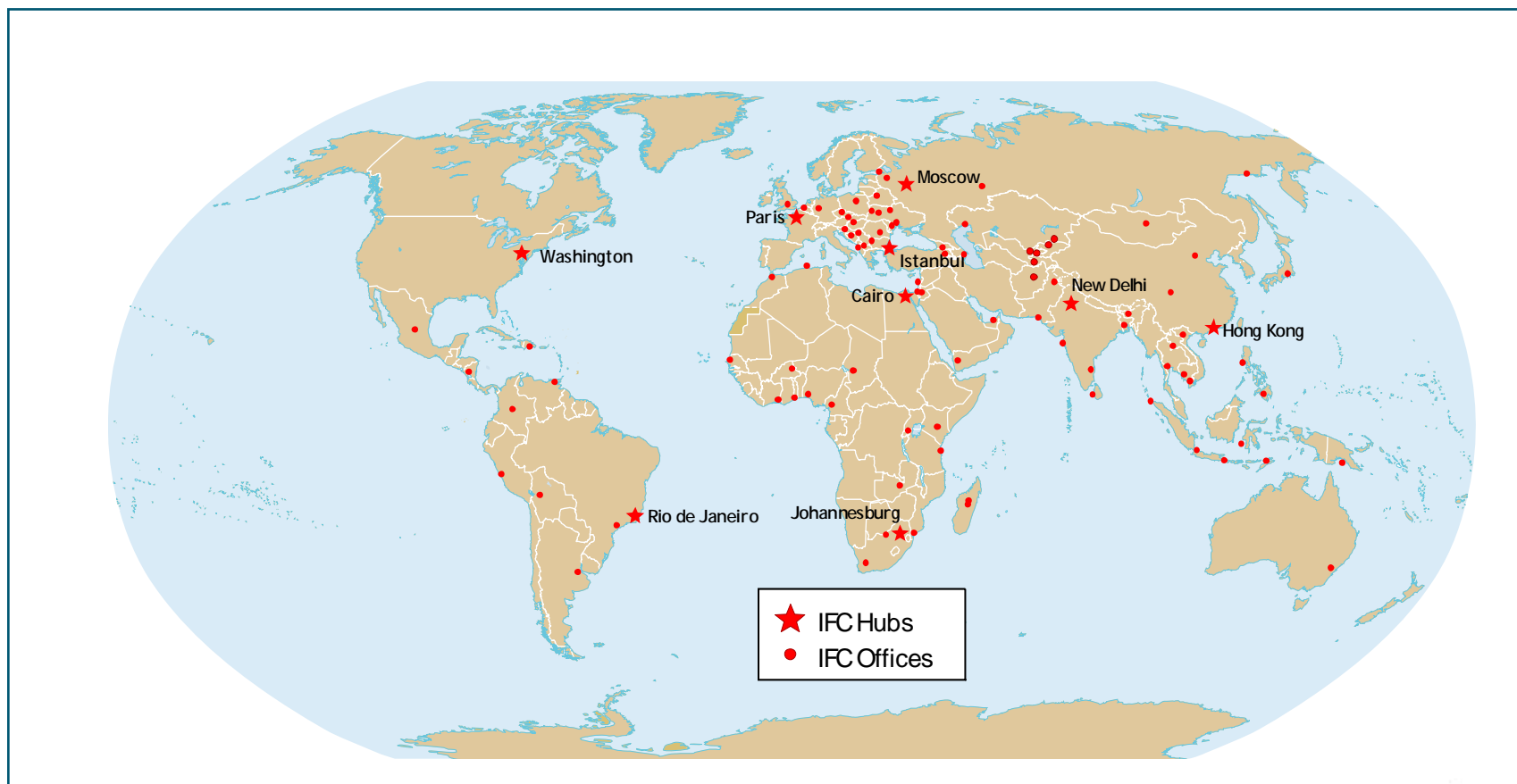
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100+ Country and Regional Offices

- IFC is the private sector arm of the World Bank Group
- Financings of \$32.4 billion in 1,400+ companies in 85 countries



IFC's Products and Services

Senior Debt

- Project finance
- Corporate finance
- Acquisition finance
- Syndication Program

Structured Finance

- Carbon credit guarantees
- Monetization of carbon credits
- Bond underwriting
- Global Trade Finance Program

Mezzanine Finance

- Convertible debt
- Subordinated debt

Equity

- Common shares
- Preferred shares

Advisory Services

- Corporate governance
- Risk management
- Small and medium business banking
- Housing finance
- Energy efficiency finance

Sustainable Finance

- Forward purchase of carbon credits
- Supply chain financing

Ownership of Emissions Reductions

Unique asset class

- Who owns the ERs?
- What parties have potential claims on this asset?
 - Financier's perspective
 - Shareholder perspective
- "Registering your claim":
 - Project Participation (specific to Kyoto Protocol)
 - MoC / Joint Instruction (specific to Kyoto Protocol)
 - ERPA
 - Distribution Agreements – Multiple Buyers/ERPAs or Participants with rights to ERs
 - Shareholder Agreements
 - Third Party Consents

Contracting Issues

- **Upfront analysis of the entitlement to the CERs:** Default scenarios:
 - Buyer default
 - Seller/project default on delivery of emissions
 - Project default on loan
- **Pricing Structures:** Price indexing/floors and caps vs. fixed price
- **Security / Collateral:** Lender can exposure to both sellers and purchasers
 - Creditworthiness of Buyer and Seller and requirements for collateral as spot prices change
- **Who is taking regulatory risks – specifics to each regulatory risk**
 - e.g, Crediting period (Kyoto): 7(x3) vs. 10 years trade-off
- **Limited jurisprudence, choice of law and dispute resolution:** Understand how your contract provisions could be interpreted and where enforcement could take place;
 - CDM projects are in emerging markets with sometimes weaker legal frameworks

Investor/Banker vs ER Buyers Needs

Tradeoffs in structuring ERs purchase/sale agreement

- Considering the potential revenues from carbon credit sales vs. the potential liabilities
 - Seller Penalties:
 - No fault termination vs. default
 - capped penalties or market damages
 - Force Majeure outs
- Negotiating lender's step-in rights; negotiating rights to the CERs as shareholder
- Lender to become comfortable with the underlying ERPA and with buyer's credit risk
- Payments should be ring-fenced by the lender

Specific Issues for Lenders

- Dispute on CER Purchase/Sale contract – price volatility, fixed price contracts
 - Joint Focal Point under Kyoto Protocol – delivery disputes can lock up project revenue
 - What happens – can a lender get step in rights if delivery disputes put project in default?
- Difficult to get security on an ERPA – asset tends to be deemed an intangible
- To use ERPA as a security, in many jurisdictions need to get waivers from all lenders for their security agreements (New York, English, Indian Law)
 - Assess risks of banking on an ERPA: In some jurisdictions, under bankruptcy law, the bankruptcy trustee may deem an ERPA not to be upheld

Guidance on Using Carbon Finance

- If using carbon assets to structure deals:
 - Get as close to ER as possible (direct from project)
 - Have lawyers and banker review ERPA before execution
 - Get necessary waivers from other project lenders
- Complications from:
 - Governing Law
 - Regulatory frameworks (Kyoto, US VERs, EU-ETS) creating the environmental asset
- Remember: ER ownership under default or contract disputes HAS NOT BEEN TESTED – will be important to test legal frameworks and establish legal precedents
- Consider using other tried and tested forms of financial structuring that can replicate carbon financing assignment of cashflows
 - e.g., debt instrument with equity kicker tied to ER delivery and pricing

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